

APPENDIX

Revenue Act of 1918, c. 18, 40 Stat. 1057, 1060:

SEC. 203. That whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.

Treasury Regulations 45 (1920 ed.):

ART. 1581. *Need of inventories.*—In order to reflect the net income correctly, inventories at the beginning and ending of each year are necessary in every case in which the production, purchase or sale of merchandise is an income-producing factor. The inventory should include raw materials and supplies on hand that have been acquired for sale, consumption or use in productive processes, together with all finished or partly finished goods. Title to the merchandise included in the inventory should be vested in the taxpayer and goods merely ordered for future delivery and for which no transfer of title has been effected should be excluded. The inventory should include merchandise sold but not shipped to the customer at the date of the inventory, together with any merchandise out upon consignment, but if such goods have been included in the sales of

the taxable year they should not be taken in the inventory. It should also include merchandise purchased, although not actually received, to which title has passed to the purchaser. In this regard care should be exercised to take into the accounts all invoices or other charges in respect of merchandise properly included in the inventory, but which is in transit or for other reasons has not been reduced to physical possession.

ART. 1582. *Valuation of inventories.*—Inventories must be valued at (a) cost or (b) cost or market, as defined in article 1584 as amended, whichever is lower. (See article 1585 for inventories by dealers in securities.) Whichever basis is adopted must be applied consistently to the entire inventory. A taxpayer may, regardless of his past practice, adopt the basis of "cost or market whichever is lower", for his 1920 inventory, provided a disclosure of the fact and that it represents a change is made in the return. Thereafter changes can be made only after permission is secured from the Commissioner. Inventories should be recorded in a legible manner, properly computed and summarized, and should be preserved as a part of the accounting records of the taxpayer. Goods taken in the inventory which have been so intermingled that they can not be identified with specific invoices will be deemed to be the goods most recently purchased.

ART. 1584. *Inventories at market.*—Under ordinary circumstances, "market" means the current bid price prevailing at the date of the inventory for the particular merchandise in the volume in which ordinarily purchased by the taxpayer, and is applicable in the cases (a) of goods purchased and on

hand, and (b) of basic elements of cost (materials, labor and burden) in goods in process of manufacture and in finished goods on hand; * * *. Where no open market quotations are available, the taxpayer must use such evidence of a fair market price at the date or dates nearest the inventory as may be available, such as specific transactions in reasonable volume entered into in good faith, or compensation paid for cancellation of contracts for purchase commitments. * * * Prices which vary materially from the actual prices so ascertained will not be accepted as reflecting the market and the penalties prescribed for filing false and fraudulent returns may be asserted. * * * The inventories of taxpayers on whatever basis taken will be subject to investigation by the Commissioner, and the taxpayer must satisfy the Commissioner of the correctness of the prices adopted. He must be prepared to show both the cost and the market price of each article included in the inventory. * * *

